



LEGAL AFFAIRS
400 R STREET, SUITE 3090
SACRAMENTO, CA 95814-6200



December 18, 1996

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RE: In the Matter of the Federal-State Joint Board on Universal Service - CC Docket
No. 96-45

Gentlepersons:

Enclosed please find an original and 10 copies of the "Comments of the California Department of Consumer Affairs on the Recommended Decision of the Federal-State Joint Board on Universal Service." Please file this document in the above matter, and return an endorsed copy to me in the enclosed stamped, self-addressed return envelope. Pursuant to FCC Rule 1.419, we have enclosed an additional five copies of our Reply Comments for distribution to each of the Commissioners.

Thank you for your assistance.

Sincerely,

VIRGINIA J. TAYLOR
Staff Counsel

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**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

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on Universal Service)
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CC Docket No. 96-45

**COMMENTS OF CALIFORNIA DEPARTMENT OF CONSUMER AFFAIRS
ON THE RECOMMENDED DECISION OF THE
FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE**

**VIRGINIA J. TAYLOR
RICHARD A. ELBRECHT**

Attorneys for

**CALIFORNIA DEPARTMENT OF
CONSUMER AFFAIRS
400 R Street, Suite 3090
Sacramento, CA 95814-6200
(916) 445-5126**

December 18, 1996

EXECUTIVE SUMMARY

In acting on the recommendations of the Federal-State Joint Board on Universal Service (Joint Board), the California Department of Consumer Affairs (DCA) urges the Federal Communications Commission ("Commission") to be mindful of the policies expressed in the Telecommunications Act of 1996 ("the Act").

Congress has mandated that the Commission interpret the Act in a manner which relies on more competition and less regulation. That too is the public understanding.

Achieving the goals of universal service -- which are valid -- does not necessarily call for government-mandated subsidies from other customers. That is because the competitive market supports universal service goals. The competitive market is achieving the same goals through advancements in technology -- a process that has placed an affordable TV in virtually everyone's home, and that will operate in all areas if the dynamics of competition are unleashed.

To the extent that industry self-interest and competition do not succeed in achieving an optimum distribution and utilization of services, some level of government intervention, including federal government intervention, may be needed. But since subsidies are always paid by other customers, it should always be a measured and principled intervention -- one that achieves valid goals efficiently.

One way to help achieve efficiency is to target subsidies to those who truly need economic help, and who would leave the market without help. A narrow focus helps to assure that limited subsidy funds are not dissipated, so that the level and quality of help that is provided to those who need help is sufficient to accomplish the goals of universal service.

The Act's requirement that subsidies must be "explicit" is still another way to help achieve an efficient subsidy process. That means that the subsidy payor and the subsidy

receiver are both made aware of the fact and amount of the subsidy.

While Congress has given the Commission a wide range of important roles, Congress has also given the Commission discretion to decline to exercise those powers. Maximum reliance ought to be placed on government entities closest to the people being served. While the nation may need federal mandates to foster competition and achieve universal service goals, the states are well equipped to implement the performance objectives the Commission sets. The states, including California, have not been inactive in this important area -- they have authorized local competition while assuring universal service.

In adopting a universal service principle of competitive neutrality, the DCA urges the Commission to apply a focus of "consumer competitive neutrality." While the DCA supports limiting universal service support to a single primary residential connection, the DCA urges the Commission to even more narrowly focus the subsidies on those who truly need economic assistance in order to remain connected to the network.

As laudable as the goals to wire schools and libraries and provide them with Internet access are, the Act does not confer on the Commission the jurisdiction necessary to implement the Joint Board's recommendations on those issues.

Rather than adopt the Joint Board's competitively discriminatory recommendation to assess a surcharge on the intrastate revenues of only those interstate telecommunications providers over which the Commission has jurisdiction, or the administrative nightmare of separating their interstate and intrastate revenues, the DCA recommends a competitively neutral all end user surcharge funding mechanism that provide consumers with information necessary for them to assess the value and benefits of the universal service program.

The DCA recommends that the Commission consider certain modifications to some of the Joint Board's proposals with respect to the Lifeline program.

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In the Matter of
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**COMMENTS OF CALIFORNIA DEPARTMENT OF CONSUMER AFFAIRS
ON THE RECOMMENDED DECISION OF THE
FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE**

I. INTRODUCTION.

The role of the Federal-State Joint Board ("Joint Board") is to thoroughly review the existing system of federal universal service support, and to recommend changes to the existing federal universal service system which will result in support mechanisms that are explicit, and which are sufficient to advance the universal service principles enumerated in the federal Telecommunications Act of 1996 ("the Act") and such other principles as the Joint Board and the Federal Communications Commission ("Commission") believe are consistent with the Act and necessary and appropriate for the protection of the public interest, convenience and necessity.¹

The following comments are submitted by the California Department of Consumer Affairs (DCA), which is charged with representing all consumers -- both low-income consumers and higher-income consumers, minorities and non-minorities, young as well as old, disabled as well as non-disabled, people who operate businesses as well as individual

¹ Recommended Decision of the Federal-State Joint Board on Universal Service ("Recommended Decision"), at ¶ 1.

residents, people who are self-employed as well as people who are employed by large and small firms, people who rely on income from investments and people who rely on income from public support programs funded by taxes, people who pay for the Lifeline and high-cost fund subsidies and people who receive the subsidized services.

The DCA endeavors to balance all of those interests and advocate positions that provides the overall greatest possible benefits to all segments of consumers, and at the least possible cost to all segments of consumers. For that reason, the focus of these comments may differ in some respects from the comments of other consumer group representatives, who may represent a specific segment of consumers, such as low-income or disabled.

With that focus in mind, the DCA respectfully submits the following opening comments in response to specific portions of the Recommended Decision of the Federal-State Joint Board on Universal Service ("Recommended Decision").

II. GOVERNING POLICY.

A. The Congressional Purposes.

As it considers the recommendations of the Joint Board, it is essential that the Commission be mindful of the policies expressed in the Act. Those policies are set forth in order to guide the Commission and the courts in interpreting and implementing the Act. The stated purpose of the Act is "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."² In carrying out that mandate, the Act requires the Commission to "seek to promote the policies and purposes of this Act favoring . . . vigorous economic competition, technological advancement, and

² Preamble to the Act.

promotion of the public interest,"³ This is a very clear mandate.

The legislative history is in accord. The preamble to Senate Bill 652 states that the Act's purpose is "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies." Additionally, the preamble to the Joint Explanatory Statement of the Committee of Conference ("Joint Conference Statement") states that the purpose of the Act is "to provide for a procompetitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition." Both of these stated purposes reflect a strong focus on promoting competition, encouraging innovation, and reducing regulation.

B. The Commission's Power of Forbearance.

In keeping with the Act's deregulatory and pro-competitive philosophy, Congress specifically gave the Commission the power to forbear from applying any provision of the Act if it makes certain findings.⁴ In making those findings, the Commission is required to consider whether forbearance would promote competition and, if it finds that to be the case, forbearance may be appropriate.⁵ Thus, Congress explicitly found that promoting and enhancing competition should be an overriding policy which guides the Commission in its interpretation and implementation of the Act.

³ The Act, Section 257(b).

⁴ The Act, Section 401(a).

⁵ The Act, Section 401(b).

In the larger public interest of promoting a competitive market for telecommunications services, the power to forbear is a power that the Commission should exercise. While the Commission has broad (but not unlimited) jurisdiction to assure that services are provided and that the charges therefor are affordable, reasonable and just, the Commission should first perform an objective appraisal of the market in each instance where government intervention will or may be undertaken to assure that the overall results will be beneficial for both consumers and the economy and certainly not counterproductive.

C. A Policy of Competition Over Regulation.

Congress has required the Commission to interpret the Act in a manner which relies on more competition and less regulation to encourage innovation, constrain prices and protect consumers. That too is the public's understanding. Most people believe that Congress decided to "unleash the market" for telecommunications services, and are surprised to learn how intrusively the Commission might regulate this industry. Therefore, it is important that the results of the Commission's regulatory process be more competition by diverse suppliers and less regulation by government. Regrettably, some of the Joint Board's recommendations go in exactly the opposite direction -- adding regulation rather than reducing regulation.

The reason Congress elected competition over regulation in this dynamic, and rapidly evolving and critically important industry is that consumers of all income levels stand to benefit far more from competition than they would from regulation. In a free, open and competitive market, consumers are able to choose among competing suppliers of a particular service, and consumer choices influence the design of the products or services and determine what is ultimately deployed. A free, open and competitive market also operates to keep prices of services fair in relation to their costs, reducing the need for an expensive, time-

consuming and innovation-stifling regulatory process. But consumer choice may be the least important reason why consumers have an interest in the development of this industry.

A bias that favors competition over regulation is of special importance to consumers because of their many and diverse roles. Most consumers of telecommunications services are also wage-earning or salaried workers whose income and consumption depends on the productivity of the economy and particular firms. Consumers who rely on income from their investments have an equal interest in the well-being of the economy, as do those who rely on income from government employment or public support programs funded by taxes. Consumers of all kinds and income levels have a vital interest in the deployment of the most advanced telecommunications throughout our economy, which is only possible if the market is allowed to most forcefully and efficiently perform its important innovation-spawning and resource-allocating functions.

When the telecommunications industry's only role was to provide "plain old telephone service," technological innovation could unfold in a relatively measured way, but even then, there were costs. According to Professor James Miller of Hampshire College, our history of pervasive regulation of telecommunications has reflected "concerns for orderly national economic growth, the more or less even social distribution of telecommunications benefits and the political accountability afforded, at least in theory, by state involvement," but Professor Miller has identified certain costs, specifically -- "lessened economic efficiency, laggard technological innovation and unresponsive bureaucracy."⁶ Today, with other competing nations installing state-of-the-art telecommunications systems, that is no longer a

⁶ Miller, James, ed., Telecommunications Equity: Policy Research Issues (New York: Elsevier Science Publishers, 1986), 49.

wise policy.

The marriage of telecommunications, computers, consumer electronics, entertainment and publishing, means that the public telecommunications system must renew itself much more rapidly if it and the economy it supports are to avoid becoming obsolete. Only if the public system is continually upgraded will it remain one that all can use. If it is not upgraded, high-end users will tend to desert it in favor of more modern systems, including private systems of their own, a process that is already well underway. Additionally, the vast majority of consumers, including low-income consumers, will be cut off from access to the ongoing innovations and products of the Information Age if the public network is not upgraded as quickly as technology and economics permit.

By opting in favor of a competitive market, Congress has announced that competitors who can offer a better or less expensive service should be allowed to do so. This approach benefits society by fostering innovation. As explained by Harvard Business School Professor Michael E. Porter:

[D]eregulation [promotes] dynamic efficiency of progressiveness or innovativeness. Research compellingly indicates that innovation is what really matters, not the price-cost margin. And yet, we concentrate on the price-cost margin and ignore how regulatory changes might affect innovation. Given the breathtaking technological changes in this industry, the real action is obviously in innovation; and so regulators must figure out how to ensure that innovation takes place.⁷

D. Universal Service Policy.

1. The Public Interest In Universal Service.

While there are good public policy reasons for allowing and fostering the emergence

⁷ Porter, Michael E., "On Thinking About Deregulation and Competition," in Sapolsky, Harvey M., et al, eds., The Telecommunications Revolution: Past, Present, and Future (London and New York: Routledge, 1992), 38 at 43.

of a competitive market for telecommunications services, there are also good public policy reasons for fostering universal access to telecommunications services. Those include:

- 1) the benefits to every customer of being able to connect with other people, businesses and government;⁸
- 2) enabling providers to make the most efficient use of fixed plant;⁹ and,
- 3) providing a broader showcase for new services, equipment and applications.¹⁰

⁸ The value of telecommunications services to individual customers who purchase and fully pay for the services increases with the number of customers on the network. It is self-evident that the value of one's telephone is influenced by the number of persons one can call, and from whom one can receive calls, and that this is a value for which there is some monetary equivalent. Increasing the number of persons who can be reached by telephone, and who place calls themselves, also increases both telephone usage and company revenues, with additional benefits to all customers. Indirect value to each customer includes the value to government and other public and private organizations whose operations are facilitated by the widespread deployment of telephone services, which redounds to the economic benefit of virtually everyone. This is a quality that markets for most other consumer products and services do not have.

⁹ Maximizing participation by customers who can be added to the network at relatively little marginal cost makes the most efficient use of fixed plant. In this industry, there are enormous fixed costs, and often also significant excess capacity. Therefore, there are valid economic reasons to maximize usage by selling services to additional customers at rates that would be "below cost" if those additional customers did not purchase the services. Experts agree that there is "tremendous cost pressure to cut price and/or add service to fill up capacity." (Porter, Michael E., "On thinking about deregulation and competition," in Sapolsky, Harvey M., et al, eds., The Telecommunications Revolution: Past, Present, and Future (London and New York: Routledge, 1992), 40.) Given freedom to set their own prices, telecommunications service providers have a strong incentive to exercise their pricing flexibility in ways that will enhance usage to its optimum (most cost-efficient) level. This is the exact function that a government-mandated universal service cross-subsidy performs.

¹⁰ Fostering a "universal market" for new applications, related customer premises equipment, information services and other telecommunications services provides a broader "showcase" for the sale of those services, which in turn reduces the cost of those services for everyone. It is very difficult to transform a new, innovative and genuinely useful product or service into a profitable one, and access to the necessary "critical mass" of customers can be extremely important. Achieving broad universal service is much like laying down the country's web of freeways: a huge volume of commerce among widely disparate geographical areas would not exist today but for the foundation of the interstate freeway and highway systems.

2. The Competitive Market Supports Universal Service Goals.

Achieving the goals of universal service does not necessarily call for government-mandated subsidies from other customers. Colin R. Blackman, editor of Telecommunications Policy, Cambridge, England, states that "[e]vidence is emerging that competition in telecommunications does not necessarily threaten universal service. Indeed," Blackman says, "where competition has been introduced, costs have fallen and penetration has risen."¹¹ Also, as noted, providers themselves have a strong incentive to achieve a high level of subscribership to pay the large cost of fixed plant. If they have adequate pricing flexibility, they will adjust their prices as needed to achieve optimum utilization of plant. That may be why most local exchange providers have enthusiastically supported Lifeline telephone service as well as subsidized service to rural areas. More important, the competitive market is already achieving the same goals of universal service through advancements in technology, a process that has placed an affordable TV in virtually everyone's home. That same dynamic will operate in all areas of telecommunications if the dynamics of competition are unleashed, nurtured, fostered and mobilized.

3. Intervention Should be Principled.

To the extent that industry self-interest and competition do not succeed in achieving an optimum distribution and utilization of services, some level of government intervention, including federal government intervention, may be needed to promote the best interests of the public. But that should always be a measured and principled intervention -- one that achieves

¹¹ Blackman, Colin R., "Universal service: obligation or opportunity," Telecommunications Policy (1995), 171, 172.

the goals of universal service most efficiently.¹² While there is no consensus on what the exact goals of universal service ought to be in an advanced, evolving, competitive telecommunications environment, they would seem to include maximizing access to and utilization of the public network by persons of all income levels without impairing the operation and evolution of the system itself. Since telecommunications is usually a cost-efficient and desirable way to perform many other kinds of tasks (e.g., transportation, and the provision of health care, education and entertainment), a policy of encouraging maximum availability and usage by all segments of society would seem wise.

However, it is easy to be beguiled by the rhetoric of universal service. Colin R. Blackman, editor of Telecommunications Policy, Cambridge, England, believes that universal service is "the stuff of myth" -- that it has been used, mainly by regulated telephone monopolies, "to support their own case for special treatment" by regulators.¹³ Milton Mueller, Assistant Professor of Information and Library Studies, Rutgers University School of Communication, points out that "[c]ross-subsidies to promote household penetration did not emerge until the 1970s. And regulators' perceived need to administer a subsidy of residential users did not come until household penetration was already approaching

¹² Eli M. Noam, Professor of Finance and Economics and Director, Columbia Institute of Tele-Information, Graduate School of Business, Columbia University, proposes a universal service program based "on the premise of competitive neutrality -- equal rights and equal burdens to all carriers in the network system." (Noam, Eli M., "Beyond liberalization III: Reforming universal service," Telecommunications Policy (1994, Vol. 18, No. 9), 687-704, at 687.)

¹³ Blackman, Colin R., "Universal service: obligation or opportunity," Telecommunications Policy (1995), 171, 172.

'universal' levels."¹⁴

If these assertions are correct -- if the concept of "universal service" has been used for political purposes by monopoly providers to protect themselves from competition, and if the universal service subsidy has not been the true engine that has brought about today's high telephone penetration rates -- it is important that policy-makers and policy-advocates take a fresh and objective look at both the history of universal service and what it ought to mean, in terms of consumers' best interests, in today's and tomorrow's Information Age. Our public policies on telecommunications should be grounded in fact -- a currently valid assessment of what universal service ought to be in a competitive telecommunications market -- and not myth.

The true origin of the term "universal service" was Theodore Vail who, as AT&T's newly re-installed president, said in AT&T's 1909 Annual Report that --

"The Bell system was founded on the broad lines of 'One System,' 'One Policy,' 'Universal Service,' ... This is no recent or new idea or theory. It is co-existent with the business. In fact, the theory was evolved and developed before the business and [the business] has been developed on that theory."¹⁵

Vail's reference to the prior development of universal service was to Western Union's nationwide, "universal," business-oriented message communications network linking terminals in all the principal commercial centers. "Western Union achieved its dominance of the industry by being the first to develop a nationally interconnected network. It used its

¹⁴ Mueller, Milton, "Universal service in telephone history," Telecommunications Policy (July 1993), 352, 355.

¹⁵ AT&T, Annual Report, 1909, 18-19, quoted in Mueller, Milton, "Universal service in telephone history," Telecommunications Policy (July 1993), 352, 356.

leverage over interconnection to isolate and destroy its rivals. Bell planned to follow in its footsteps."¹⁶ "Vail conceived of universal service as an integrated monopoly that could interconnect all telephone users. Implementing this vision required eliminating access competition" -- that is, competition from independent telephone companies that were not interconnected with AT&T.¹⁷ The following statement from AT&T's 1910 Annual Report contains the essence of Vail's conception of universal service:

"[The Bell system] believes that the telephone system should be universal, interdependent and intercommunicating, affording opportunity for any subscriber to any exchange to communicate with any other subscriber of any other exchange within the limits of speaking distance."¹⁸

The conclusion is inescapable that interconnection, not social or geographic ubiquity, was the basic issue being addressed. "Unless the network developed under the guidance of a single firm," Vail contended, "telephone users' ability to make connections with exchanges in other location would be thwarted by a lack of coordination and technical incompatibility."¹⁹ Thus, the concept of universal service really was intended to address the destruction of "access competition" and the creation of a single integrated telephone system with legal monopoly status.

While the complete history is beyond the scope of these comments,²⁰ the concept

¹⁶ Id., at 357.

¹⁷ Id., at 363, 364.

¹⁸ AT&T, 1910 Annual Report, 43, quoted in Mueller, Milton, "Universal service in telephone history," Telecommunications Policy (July 1993), 352, 363.

¹⁹ Mueller, Milton, "Universal service in telephone history," Telecommunications Policy (July 1993), 352, 364.

²⁰ For a fuller history, see Mueller, Milton, "Universal service in telephone history," Telecommunications Policy (July 1993), 352.

referred to AT&T's "commitment to interconnect all telephone users into one big, integrated system."²¹ By 1907, AT&T had controlled about 51% of the nation's telephones and independent companies controlled about 49% of the telephones.²² However, the systems were not interconnected, and dual exchanges existed in about 57% of the cities. Universal service was conceived of as a method of competition using government to create a protected status for a single, integrated, legally-protected monopoly provider. Vail believed that "monopoly, and not interchange of traffic among the competing systems, was the best way to achieve universal service."²³

Vail's strategy is described in The Regulation Game: Strategic Use of the Administrative Process (1978), where economists Bruce M. Owen and Ronald Braeutigam state: "No industry offered the opportunity to be regulated should decline it.... Regulation protects such industries against competition from outsiders and from within the industry. It provides protection from antitrust attack. It provides a degree of protection from congressional investigation. Regulation greatly reduces the risk of bankruptcy from causes other than competition. And, while regulation may make very high rates of return difficult to achieve, it does virtually guarantee a steady stream of adequate profits."

The period in the history of U.S. telecommunications in which there was access competition -- that is, dual competing but not interconnected telephone systems -- lasted for about 25 years, longer than our current experience with long-distance competition. At its

²¹ Mueller, Milton, "Universal service in telephone history," Telecommunications Policy (July 1993), 352, 363,

²² Id., at 362, 363.

²³ Id., at 364.

peak, around 1904-14, more than 55% of the U.S. population lived in cities or towns where there were two unconnected telephone exchanges. During this period, the dual systems competed with each other for customers by offering their customers a broader range of coverage.²⁴

As a result of this competition, some of the goals of today's concept of universal service were achieved. For instance, there was an enormous expansion in the number of rural and small-town exchanges and a rapid rise in telephone penetration generally; but rural households had, on average, the highest levels of telephone penetration. In 1920, 38.7% of U.S. farms had telephones, versus 30% of all U.S. households. Farm households in states such as Ohio, Indiana, Illinois, Kansas and Nebraska, where independent telephony was strongest, reported subscription rates of 60% and 70%. The most surprising statistic relates to Iowa, where 86% of the 213,439 farms reported telephones in 1920.²⁵

The DCA urges the Commission to be cognizant of both the history of universal service, including its early achievement in rural America without subsidy help, its alleged use as a lobbying technique by the old A.T.&T., and the Act's mandates and vision of the future.

4. The Potential for Unprincipled Intervention.

There are many ways for government to intervene on an unmeasured and unprincipled basis. For instance, government intervention might be counterproductive if it stifles innovation or forces customers of overpriced services to bypass the public network and

²⁴ Mueller, Milton, "Universal service in telephone history," Telecommunications Policy (July 1993), 352, 359.

²⁵ Id., at 358, 369.

thereby increase the prices paid by customers who remain on the network. Similarly, government intervention can result in burdening groups of customers who are in greater need of help than those actually receiving it -- a morally indefensible result.

A key problem is that regulation to help achieve universal service usually results in implicit or explicit subsidies from one customer group or product to another customer group or product. In the final analysis, any regulation-mandated subsidy that entails any cost to a provider is paid for by those customers who do not receive the subsidy. There is no free lunch. While owners may share some of a regulatory burden, that does not normally occur in a competitive market. As Commissioner Ness has recognized, "the funds for universal service ultimately come from consumers;" . . .²⁶

To achieve fairness to the those customers who fund a subsidy, the burden of the subsidy should always be kept as low as possible, so as not to burden other customers needlessly (and, ipso facto, unfairly). As expressed by Commissioner Ness, "[t]here is no reason why ratepayers as a whole should bear the burden of supporting multiple lines to a single residence, single lines to second homes, or multi-line businesses."²⁷

Minimizing subsidies is therefore called for by Section 254(b)(1) of the Act, which states that universal service programs must result in rates that are not only "affordable," but also "reasonable" and "just." If the rate charged to a subsidy-paying customer is increased beyond what is needed to accomplish a valid universal service goal, it is difficult to argue that the charge is not "unreasonable" and "unjust," and hence violative of Section 254(b)(1).

There is another reason for concern when adopting regulations that favor one

²⁶ Separate Statement of Commissioner Susan Ness, November 7, 1996, at p. 2.

²⁷ Separate Statement of Commissioner Ness, at p. 2.

customer over another. Since regulation is inevitably crude -- since regulation almost inevitably lumps diverse persons into single groups -- a cross-subsidy usually involves some measure of unfairness, in that at least some customers in the paying group may be in greater need of economic assistance than the customers in the receiving group. For instance, many low-income Californians pay a great deal for long-distance calls to their relatives and friends in Mexico; overcharging for long-distance calls to subsidize services to other customers is unfair to a low-income person or a marginally low-income person who makes many long-distance calls. Similarly, many owners or operators of small businesses are poor -- whole families often staff them -- and overcharging them to subsidize other customers would seem to be highly unfair to them. For particular customers in a paying group, the basic unfairness of a needlessly excessive subsidy is exacerbated, and the subsidy program may be even more unjustified, both morally and economically. If a subsidy program could be made perfect, there would be less of a problem, but "social engineering" tends to be imperfect and usually has unanticipated consequences.

A more basic problem with a subsidy program in an industry like telecommunications, where continuing advancements in technology and innovations in services are important to both individual customers and the economy, is that the resulting overcharge is essentially a tax on an important and presumably favored activity. Like all taxes, it deters rather than spurs that activity. While some level of surcharge to support universal service goals will promote the overall efficiency of the system, a surcharge that is excessive will be counterproductive. While it is impossible to specify what that level is, the potential for excessive and therefore deleterious overpricing should be kept in mind in establishing the level of subsidy support to achieve universal service goals.

Overcharging one customer group or service in order to benefit another customer group or service also distorts market signals, and thereby misdirects research, product development and marketing, resulting in inefficient markets, in the unavailability of services that might otherwise be provided, and, overall, in the industry's provision of relatively less value to all customers and to society. For instance, subsidizing rural services reduces the incentive to competing entrepreneurs to develop and deploy new technologies which would cost more than the retail price of the subsidized service but less than the real cost of the subsidized service to society. This may be why established telephone companies support cross-subsidies to rural customers -- to forestall competitive entry by more efficient providers. It is important that the Commission avoid playing that game.

5. Targeting Subsidies on Those Who Need Help.

A good way to help achieve efficiency is to target subsidies to those customers who truly need economic help, and who would leave the market without that help. Brookings Institution economist Robert W. Crandall concurs: "[T]he attempt to use telephone rates as mechanisms for redistributing income is costly, reducing social output by more than two dollars for every dollar transferred from upper-income to lower-income households. It is far better to target subsidies to very low-income households through Universal Service funds or other mechanisms than to distort rates for all telephone subscribers."²⁸ That means, for instance, that in principle, customers who make local calls should not be subsidized by overcharging customers who make long-distance calls, that affluent rural customers should not be subsidized by overcharging urban customers (including many residential and business

²⁸ Crandall, Robert W., After the Breakup (Washington, D.C.: The Brookings Institution, 1991), p. 164.

customers who might be in greater need), and that college-attending children of affluent parents should not be subsidized by consumers who make long-distance calls, by the working poor of our inner cities, or by their parents' less affluent neighbors.

Denying a subsidized service to those who can afford the service without assistance and who would procure it, if they wanted it, in any event, would also help assure that the limited subsidy funds are not dissipated, so that the level and quality of help that is provided to those who actually need economic help is sufficient to accomplish the goals of universal service. As the Information Age unfolds, society may wish to provide even greater help to those who truly need economic help, broadening the range and quality of the subsidized services. As expressed by Professor Robert Harris of the School of Business at the University of California, Berkeley, "[i]f policymakers decide that universal service includes certain enhanced services, direct targeted subsidies may be warranted."²⁹

Creating programs that distribute subsidies indiscriminately forecloses that option by taking on a life of its own while also failing to accomplish its original mission. For the reasons given in Part II of these comments, it is not clear that the Joint Board has been as cautious in that regard as it ought to be.

6. Support to Schools and Libraries.

Support to schools and libraries is a vital subsidy. An important aspect of assuring that the advent of competition in the telecommunications market does not result in a society of information "have nots" is assuring that new information technologies are available in America's schools and libraries. A carefully designed and efficient program of support to

²⁹ Schmandt, Jurgen, Frederick Williams, and Robert H. Wilson, Telecommunications Policy and Economic Development: The New State Role (New York, N.Y.: Praeger Publishers, 1989), pp. 27-28.

schools and libraries will help ensure that every student, and the public are large, have the opportunity to obtain the training essential to participate in the new Information Age. Every day that a school or library does not have adequate access to the latest in telecommunications and advanced information technologies is another day closer to the graduation of students who will not have the skills needed to obtain and maintain employment in the rapidly changing, highly technological work environment of today and tomorrow. No one doubts that the U.S. must do all that it can to connect our schools and libraries to the Information Age's information suppliers.

Special support to schools and libraries is inevitably a highly-focused and highly-efficient kind of subsidy. It not only provides needed education and skill development to the young people who will need those qualities when they seek employment, but it also showcases new technologies and creates the foundation for markets where none might otherwise exist, thereby accelerating the deployment of new applications and forcing down their prices.

7. Making Subsidies Explicit.

Section 254(e) of the Act requires that subsidies to achieve universal service goals be "explicit." The Joint Conference Statement confirms that "[t]o the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today" (Joint Conference Statement, p. 16.), and that it is "the conferees' intent that all universal service support should be clearly identified" (*Id.*, at p. 17).

Commissioner Rachelle B. Chong has also recognized that a key task of the Joint Board "is to identify all implicit universal service subsidies and to either remove them or

make them explicit."³⁰ Making all coerced subsidies explicit helps achieve a subsidy process that is both efficient and democratic. In that way, the subsidy payor and the subsidy receiver are both made aware of the fact and amount of the subsidy, and in that way, the democratic process helps sort out the equities on a long-term basis. Both payors and receivers know what is happening and can register their approval or concerns to the regulators and their elected representatives.

8. Performance Standards for the States.

While Congress has given the Commission a wide range of important roles, Congress has also given the Commission discretion to decline to exercise those powers. There is a growing consensus that the greatest possible reliance ought to be placed on the government entities closest to the people who are being served. While telecommunications has qualities that are "nationwide" and even "worldwide," everyone lives and works in a locality that is distinguished from every other locality, and our public policies and laws should reflect local needs and conditions insofar as possible. While the Commission has broad jurisdiction, its most constructive role might be the adoption and policing of performance standards, leaving their implication first to the industry and then to state regulators. The Commission should not attempt to do things that the private sector or local government can do -- and, in the case of California and many other states, are already doing well. While the nation as a whole may need federal mandates to foster competition and achieve universal service goals for the country as a whole, the states are well equipped to implement those policies the details and should be allowed to do so.

³⁰ Separate Statement of FCC Commissioner Rachelle B. Chong Concurring in Part, Dissenting in Part, November 7, 1996, at p. 1.